



# **COMPLIANCE AND CONTROL AUDIT REPORT**

## **State Hospitals**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
October 2003**

# ***Legislative Post Audit Committee***

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## ***Legislative Division of Post Audit***

**The Legislative Post** Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$9 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of government agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U. S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. These audit standards have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the representatives, three are appointed by the Speaker of the House and two are appointed by the House Minority Leader.

As part of its audit responsibilities, the Division is charged with meeting the requirements of the Legislative Post Audit Act which address audits of financial matters. Those requirements call for two major types of audit work.

First, the Act requires an annual audit of the State's financial statements. Those statements, prepared by the Department of Administration's Division of Accounts and Reports, are audited by a certified public accounting firm under contract with the Legislative Division of Post Audit. The firm is selected by the Contract Audit Committee, which comprises three members of the Legislative Post Audit Committee (including the Chairman and Vice-

Chairman), the Secretary of Administration, and the Legislative Post Auditor. This audit work also meets the State's audit responsibilities under the federal Single Audit Act.

Second, the Act provides for a regular audit presence in every State agency by requiring that audit work be conducted at each agency at least once every three years. Audit work done in addition to the annual financial statement audit focuses on compliance with legal and procedural requirements and on the adequacy of the audited agency's internal control procedures. These compliance and control audits are conducted by the Division's staff under the direction of the Legislative Post Audit Committee.

### **LEGISLATIVE POST AUDIT COMMITTEE**

Representative John Edmonds, Chair  
Representative Tom Burroughs  
Representative Bill McCreary  
Representative Frank Miller  
Representative Dan Thimesch

Senator Derek Schmidt, Vice-Chair  
Senator Bill Bunten  
Senator Anthony Hensley  
Senator Dave Kerr  
Senator Chris Steineger

### **LEGISLATIVE DIVISION OF POST AUDIT**

800 SW Jackson  
Suite 1200  
Topeka, Kansas 66612-2212  
Telephone (785) 296-3792  
FAX (785) 296-4482  
E-mail: [LPA@lpa.state.ks.us](mailto:LPA@lpa.state.ks.us)  
Website: <http://kslegislature.org/postaudit>  
Barbara J. Hinton, Legislative Post Auditor

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*LEGISLATURE OF KANSAS*  
***LEGISLATIVE DIVISION OF POST AUDIT***

800 SOUTHWEST JACKSON STREET, SUITE 1200  
TOPEKA, KANSAS 66612-2212  
TELEPHONE (785) 296-3792  
FAX (785) 296-4482  
E-MAIL: [lpa@lpa.state.ks.us](mailto:lpa@lpa.state.ks.us)

October 17, 2003

To: Members, Legislative Post Audit Committee

Representative John Edmonds, Chair  
Representative Tom Burroughs  
Representative Bill McCreary  
Representative Frank Miller  
Representative Dan Thimesch

Senator Derek Schmidt, Vice-Chair  
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This report contains the findings, conclusions, and recommendations from our completed compliance and control audit of the State Hospitals.

The report includes several recommendations for improving the hospitals' procedures for handling patient revenues and pharmacy inventories. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is written in a cursive, flowing style with a large, prominent initial 'B'.

Barbara J. Hinton  
Legislative Post Auditor



## EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

### Question 1: Did the State Hospitals Have Adequate Procedures To Ensure That They Handled Patient Revenues Appropriately?

**With one exception, the State hospitals had adequate procedures to ensure that they handled patient revenues appropriately.** ..... page 3  
*Osawatomie State Hospital didn't use its calculated daily rate for room and board charges, but the impact of that (if any) was minimal. Amounts paid by Medicare, Medicaid, and insurance benefits are adjusted to the correct amounts regardless of the amount charged, and almost all of the remaining charges are written off because of limited patient resources. In addition, for Osawatomie State Hospital, Rainbow Mental Health Facility, and Larned State Hospital, the portion of patient account balances past due more than one year increased during the past year.*

**Recommendation** ..... page 5

### Question 2: Did the State Hospitals Have Adequate Procedures To Ensure That They Properly Controlled Pharmacy Inventories?

**Most State hospitals had established reasonable procedures to account for drugs, but procedures at 2 hospitals may need to be improved.** ..... page 6  
*Weaknesses in systems and procedures at Larned and Parsons State Hospitals can sometimes result in inaccurate drug inventory records. Better adherence to established processes and a review of the computerized inventory systems would help address these concerns.*

**Recommendations** ..... page 7

**Appendix A: Agency Response** ..... page 8

This audit was conducted by Randy Tongier. If you need any additional information about the audit's findings, please contact Mr. Tongier at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at [LPA@lpa.state.ks.us](mailto:LPA@lpa.state.ks.us).



## State Hospitals

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The Legislative Division of Post Audit has conducted compliance and control audit work at the State's hospitals—Osawatomie State Hospital, Rainbow Mental Health Facility, Larned State Hospital, Kansas Neurological Institute, and Parsons State Hospital. Compliance and control audits can identify noncompliance with applicable requirements and poor financial-management practices. The resulting audit findings often identify needed improvements that can help minimize the risk of potential future loss or misuse of State resources.

At the direction of the Legislative Post Audit Committee, this audit focused on the hospitals' handling of patient revenues and pharmacy inventory. The audit addresses the following specific questions:

- 1. Did the State Hospitals have adequate procedures to ensure that they handled patient revenues appropriately?**
- 2. Did the State Hospitals have adequate procedures to ensure that they properly controlled pharmacy inventories?**

To answer these questions, we reviewed applicable statutes and regulations, and identified standard financial-management practices. We also interviewed appropriate hospital staff members, and reviewed hospital files and records. This audit work covers fiscal year 2003.

In conducting this audit, we followed all applicable government auditing standards.

## STATE HOSPITALS AT A GLANCE

Expenditure by Type and Source  
Fiscal Year 2003

	Larned State Hospital	Osawatomie State Hospital	Rainbow Mental Hlth Facility	Parsons State Hospital	Kansas Neurological Institute	ALL
<b>Types of Expenditure:</b>						
Salaries and Wages	\$ 25,189,970	\$ 15,688,432	\$ 4,969,472	\$ 17,172,130	\$ 20,421,449	\$ 83,441,453
Other	8,177,411	4,322,574	1,762,878	3,702,385	4,355,350	22,320,598
TOTAL	\$ 33,367,381	\$ 20,011,006	\$ 6,732,350	\$ 20,874,515	\$ 24,776,799	\$ 105,762,051
<b>Sources of Funding:</b>						
State General Fund	\$ 11,851,457	\$ 4,783,404	\$ 512,610	\$ 6,110,800	\$ 8,930,202	\$ 32,188,473
Medicaid	7,491,730	11,163,625	5,579,439	12,935,736	13,559,127	50,729,657
Other	14,024,194	4,063,977	640,301	1,827,979	2,287,470	22,843,921
TOTAL	\$ 33,367,381	\$ 20,011,006	\$ 6,732,350	\$ 20,874,515	\$ 24,776,799	\$ 105,762,051
<b>Est. Ave. No. of Patients</b>	280	180	45	190	180	875



## Question 1: Did the State Hospitals Have Adequate Procedures To Ensure That They Handled Patient Revenues Appropriately?

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The State hospitals' procedures for handling patient revenues generally were well-designed and operating effectively during the period we reviewed. We noted one instance where the hospital didn't use the established rate in charging patient accounts. However, because of the manner in which patient charges are paid, the impact of not using the established rate on amounts actually collected was minimal. We also noted that for three of the hospitals, a significant portion of the patient account balances had been due and unpaid for a significant amount of time. These findings are discussed in more detail in the sections that follow.

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### ***With One Exception, State Hospitals Had Adequate Procedures To Ensure That They Handled Patient Revenues Appropriately***

The State Hospitals, under administrative guidance from the Department of Social and Rehabilitation Services, are responsible for developing and implementing procedures to ensure that they collect and deposit the appropriate amounts of patient-related revenues in a manner consistent with any applicable legal requirements. Patient-related revenues include amounts due for room and board, lab services, medications, and other services. Some of the hospitals charge patient accounts separate amounts for each type of service, the others charge for all services to patients as part of a single daily rate. Regardless, the hospitals should ensure that they do the following:

- set billing rates in accordance with State law
- charge patients for services provided at the established rates
- bill appropriate parties for their share of patient account charges
- collect amounts that are billed
- credit amounts collected to patient accounts
- deposit amounts that are collected on a timely basis

To identify and evaluate the procedures used by the hospitals, we interviewed officials, reviewed applicable accounting records and files, and tested samples of charges to patient accounts, collections, and deposits both to local bank accounts and the State Treasury.

**Osawatomie State Hospital didn't use its established daily rate for room and board charges to patient accounts, but the impact of that (if any) was minimal.** In accordance with State law, Osawatomie State Hospital developed a daily room and board rate for fiscal year 2003 based on anticipated costs. That rate was \$283 per day. However, during fiscal year 2003 the Hospital charged patient accounts for room and board at the rate of \$289 per day, \$6 a day higher than the established rate. According to the Business Manager, the higher

rate was the one in place for the previous fiscal year, and the change wasn't made because the rates were so similar.

Although it may seem that by using the higher rate the Hospital would have collected more revenue than it should have, we think that was unlikely because of the way most patient charges are handled. Patient charges are liquidated in the following ways:

- Medicare or Medicaid—When these benefits are used, the hospital files a claim, the claim is paid, an annual cost study is done, and based on the cost study a financial adjustment is made (the hospital gets more money or pays money back). At the end of this process, the hospital has been paid the correct amount, even if the original claim used a higher rate than it should have. For our sample of accounts at Osawatomie State Hospital, these benefits accounted for 23% of patient charges.
- Private Insurance—When these benefits are used, the hospital files a claim, the claim is paid subject to maximum allowable amounts. Amounts in excess of the maximum are written off. At the end of this process, the hospital has been paid the correct amount, even if the original claim used a higher rate than it should have. For our sample of accounts at Osawatomie State Hospital, these benefits accounted for 7% of patient charges.
- Hospital Write-Offs Because of Insufficient Resources—At admission, the hospital identifies the patient's financial resources and determines the amount of any patient financial obligation. Charges in excess of this obligation and not covered by available benefits are written off. In general, patients and families at State hospitals have very limited financial resources, and the patient obligations aren't sizeable. As a result, significant amounts of patient charges are written off. Even if charges written off are based on higher rates than should have been used, that doesn't affect the amount the hospital collects. For our sample of accounts at Osawatomie State Hospital, write-offs accounted for 70% of patient charges.
- Patient and Family Moneys—The hospital may collect some moneys from patients with sufficient financial resources. In those cases, it's possible that using a higher rate than should have been used will result in the hospital collecting too much money. However, it's not very likely in this case because, with limited patient resources, Osawatomie State Hospital doesn't collect significant amounts from patients. For our sample of accounts, no patient moneys had been collected yet, and the most that might be collected in the future would be less than half a percent of patient charges.

**For Osawatomie State Hospital, Rainbow Mental Health Facility, and Larned State Hospital, the portion of the patient account balances due and unpaid for a significant amount of time has increased during the past year.** Each year, State agencies report to the Division of Accounts and Reports the amounts of their receivables categorized by how long the balances have been outstanding. Those figures for the most recent two fiscal years show that a significant portion of the patient account balances at Osawatomie State Hospital, Rainbow Mental Health Facility, and Larned State Hospital have been outstanding for a significant amount of time. The reported figures are shown in the table below.

Percentage of Patient Account Balances Outstanding More Than One Year		
	Fiscal Year 2002	Fiscal Year 2003
Osawatomie State Hospital	6%	47%
Rainbow Mental Health Facility	17%	48%
Larned State Hospital	65%	78%

For each of these hospitals, the percentage of account balances outstanding for more than a year has increased substantially. According to Osawatomie State Hospital officials, who administer both Osawatomie and Rainbow's patient accounts, the increase at those hospitals is mainly because of difficulty resolving Medicare/Medicaid claims together with a current vacancy in the position responsible for supervising patient accounts. According to Larned State Hospital officials, the high percentage of balances outstanding more than a year relates in large part to amounts due from United Methodist Youthville, a bankrupt former foster care provider.

***Recommendation***

To ensure that patients are charged the appropriate rate for room and board, Osawatomie State Hospital should use the rate calculated annually as called for by K.S.A. 59-2006b.

## Question 2: Did the State Hospitals Have Adequate Procedures To Ensure That They Properly Controlled Pharmacy Inventories?

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The State hospitals' procedures for controlling pharmacy inventories generally were adequate to ensure that they properly controlled pharmacy inventories, but some improvements could be made. At Larned State Hospital, drug quantities recorded in the inventory records differed significantly from quantities actually on hand for some items tested. At Parsons State Hospital, it appeared that there might be a problem with the computerized inventory system that may produce inaccurate inventory quantities. The basis for our conclusion is presented below.

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### ***Most State Hospitals Had Established Reasonable Procedures To Account For Drugs, But Procedures at 2 Hospitals May Need To Be Improved***

The State Hospitals, under administrative guidance from the Department of Social and Rehabilitation Services, are responsible for developing and implementing procedures to ensure that they properly control pharmacy inventories. In doing so, the hospitals should ensure that they do the following:

- record drug purchases in inventory records
- record drugs dispensed in inventory records
- physically control drugs on hand in secure areas
- periodically count inventory items and compare those counts to recorded amounts, as required by regulations for controlled substances (narcotics)

To identify and evaluate the procedures used by the hospitals, we interviewed officials, reviewed applicable accounting records and files, tested samples of drugs purchased and dispensed, and counted samples of drugs and compared those counts to the inventory records.

For the most part, we found that the hospitals had these types of procedures in place and adhered to them. However, there were two areas that need to be addressed as discussed below.

**We noted weaknesses in the systems established at Larned and Parsons State Hospitals that can sometimes result in inaccurate drug records.** Larned and Parsons State Hospitals track all drugs on an ongoing basis. Hospital officials told us controlled substances are subject to more extensive controls (such as more frequent physical counts and more detailed recordkeeping) than other drugs.

*At Larned State Hospital, the amounts of drugs on hand differed significantly from the inventory records for 2 of the 6 sample drugs we reviewed.* For one drug, inventory records showed that 611 capsules should have been on hand. Our count was 1,614—a

difference of 1,003 capsules. Likewise, inventory records for the other drug showed 4,281 pills on hand. Our test count was 4,784. In each case, the number actually on hand was more than the records indicated should be there. Therefore, theft or loss of the medications isn't a concern.

The head pharmacist told us that the manufacturer of the first drug has a program that provides free replacements for repeat users. Drugs received under this program don't go through the same check-in process as drugs that are purchased because there's no purchase order or invoice. However, the pharmacist said that those drugs should still be recorded when received. The pharmacist thought that some of these drugs weren't recorded when received as they should have been, thereby resulting in more drugs actually being on hand than the records showed.

In addition, we were told that the computerized inventory system at Larned State Hospital couldn't provide a history of purchases for a given drug being logged into the inventory system. That means that if there were a difference between a physical count of a drug and the quantity recorded in the inventory records, pharmacy staff wouldn't have a record of the purchase activity to help them determine the reason for the difference.

*At Parsons State Hospital, there appears to be a glitch in the computer system that may produce inaccurate drug inventory counts.* When we tested the drug inventory at Parsons, the records showed the quantity on hand for one of the drugs to be 27 capsules. Our count was 387—a difference of 360 capsules. In researching the difference, we noted that an inventory taken in late July showed 280 pills on hand, which agreed with the inventory records at that time.

Since that time, the computer history file on the drug showed 300 capsules purchased and 193 being dispensed. Therefore, the computer should have shown a quantity of 387 capsules at the time of our audit, which exactly matched the amount actually on hand. We were unable to explain why the computer indicated only 27 capsules on hand at the time of our audit.

***Recommendations***

1. To ensure that its inventory records are as accurate as possible, Larned State Hospital should remind pharmacy staff to record in the inventory records all drugs received, even those not actually purchased, and should attempt to develop the ability to access a history of recorded inventory purchases.
2. To ensure that its inventory records are as accurate as possible, Parsons State Hospital should review its pharmacy inventory computer system for possible glitches in calculating quantities on hand.

## **APPENDIX A**

### **Agency Response**

On October 8, 2003, we provided copies of the draft audit report to the State hospitals and the Department of Social and Rehabilitation Services. Their response is included as this Appendix.

That response provided additional information about how three of the hospitals set charges for lab services. Based on that additional information, we made changes to the draft report. Those changes don't affect the overall conclusion, but do eliminate one preliminary finding and recommendation.



# K A N S A S

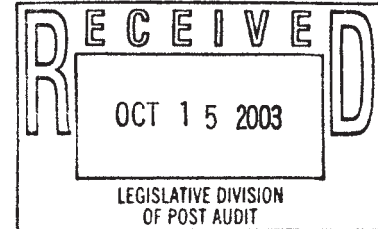
JANET SCHALANSKY, SECRETARY

SOCIAL AND REHABILITATION SERVICES

KATHLEEN SEBELIUS, GOVERNOR

October 15, 2003

Barbara J. Hinton  
Legislative Post Auditor  
800 S.W. Jackson Street, Suite 1200  
Topeka, Kansas 66612-2212



Dear Ms. Hinton,

Thank you for the opportunity to review your recent compliance and control audit of the state hospitals. I was pleased to hear that your staff found that the procedures for handling patient revenues were generally well designed and operating efficiently. I was also pleased that the state hospital's procedures for controlling pharmacy inventories were generally found to be adequate. The following provides responses to the specific findings listed in the report.

**Recommendation:** To ensure that patients are charged the appropriate room rate, Osawatome State Hospital should use the rate calculated annually as called for by K.S.A. 59-2006b.

**Response:** Due to an administrative oversight room rate charges, while decreased for the period reviewed, were billed at the previous year's higher rate. While, as the audit noted, this did not result in any material gain in actual collections we recognize we failed to follow proper hospital procedure. Systems are currently in place to prevent such further occurrences of under/over billing for daily room rates.

**Recommendation:** To ensure the lab charges are made according to state law, Larned State Hospital (LSH), Osawatome State Hospital (OSH), and Rainbow Mental Health Facility (RMHF) should charge patients for lab services based on costs as called for by K.S.A. 59-2006b.

**Response:** It appears we did not adequately explain how ancillary charges, including those for laboratory, are established. A comprehensive study was performed several years ago to determine the cost of various services. Since that time these are reviewed each year in regard to how the charges established compare to the Medicare cost report. The charges are then adjusted annually to reflect changes in costs. In this way charges and costs are maintained as close to equal as feasible.

As this method relates to laboratory charges it should be noted that in January 2003 charges for laboratory services were adjusted to reflect increased costs which were identified through a review of the FY 2002 cost report. Similar adjustments will be made after the submission of the FY 2003 cost report due to be submitted on November 30, 2003.

DOCKING STATE OFFICE BUILDING, 915 SW HARRISON STREET, 10<sup>TH</sup> FLOOR, TOPEKA, KS 66612-1570  
Voice 785-296-6999 FAX 785-296-5507 [www.srskansas.org](http://www.srskansas.org)



This method will be assessed to confirm it meets the rate setting requirements described in the statute.

Observation: The audit noted that the high percentage of balances outstanding for more than a year at LSH relate in large part to amounts due from United Methodist Youthville, a former foster care provider.

Response: We would like to note that United Methodist Youthville (UMY) is still under contract with SRS to provide foster care services. UMY is working closely with SRS to resolve all of its past due bills at LSH.

Recommendation: To ensure that its inventory records are as accurate as possible, LSH should accurately record all drugs received, even those not listed on a purchase order, and should attempt to develop the ability to access a history of recorded inventory purchases.

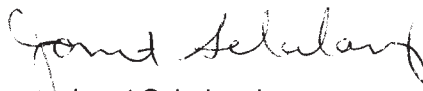
Response: LSH has begun accurately recording all drugs received. LSH is also exploring the possibility of using a different computer system that would maintain a history of recorded inventory purchases. In the future, LSH will proceed to charging for doses administered on electronic Medication Administration Records versus individual patient prescription charges so a perpetual inventory will no longer be maintained. The charging of dosages administered will have the positive effect of increased accuracy plus an enhanced safety factor with the use of bar coding to identify potential medication variances as highly recommended by the Patient Safety Standards of the Joint Commission of Accreditation of Healthcare Organizations.

Recommendation: To ensure that its inventory records are as accurate as possible, Parsons State Hospital and Training Center (PSH&TC) should review its pharmacy inventory computer system for possible glitches in calculating quantities on hand.

Response: PSH&TC has contacted the software company (KALOS in Topeka, KS) and asked for their help to find and repair any "glitches" that could be the result of programming errors in the KALOS software. At present, the specific problem has not been identified, but KALOS has assured the PSH&TC pharmacy staff that they will work to resolve any software issues as soon as possible.

Thank you again for this opportunity to respond. If you have any questions or concerns about this response do not hesitate to contact Laura Howard, Deputy Secretary of Health Care Policy.

Sincerely,



Janet Schalansky  
Secretary



## **APPENDIX A**

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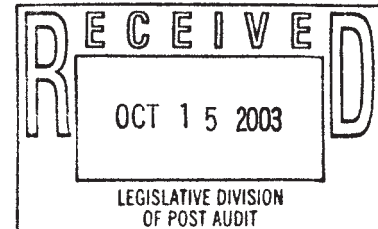
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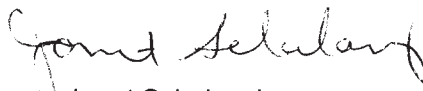
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